No. 8409.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

J. N. Hendrickson,
Complainant,

vs.

El Camino Oil Company, Ltd., a Corporation,
Respondent.

State of California,
Creditor and Appellant,

vs.

H. A. Meek, as Receiver of El Camino Oil Company, Ltd., a Corporation,
Receiver and Appellee,

F. R. Kenney and L. W. Wickes,
Creditors and Appellees.

BRIEF OF APPELLEES KENNEY AND WICKES.

A. Maxson Smith,
Title Ins. Bldg., 433 So. Spring St., Los Angeles,
Attorney for Appellees F. R. Kenney and L. W. Wickes.

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BRIEF OF APPELLEES KENNEY AND WICKES.

STATEMENT OF THE CASE.

Appellees F. R. Kenney and L. W. Wickes feel that appellant has made a fair and proper statement of the case both as to facts (Appellant's Opening Brief, pp. 4-8) and as to the questions involved (Appellant's Opening Brief, pp. 8-14) and therefore will make no additional statement.

Outline of Argument.

I. The claim of F. R. Kenney and L. W. Wickes is secured by a chattel mortgage dated the sixth day of June, 1930, executed by El Camino Oil Company, Ltd., respondent herein, and recorded in the office of the County Recorder of Los Angeles County the tenth day of June, 1930.

Argument based on principle.

II. The deed of trust executed June 7, 1930, by El Camino Oil Company, Ltd., created and constitutes a valid and existing lien, as against the State of California, upon the property described in said deed of trust as Parcel II.

California Civil Code, Sections 657, 2220, 2924 and 2957;

Insurance Co. v. Haven, 95 U. S. 251;

Hawkins v. Trust Co., 79 Fed. 50;

Weber v. McCleverty, 149 Cal. 316; 86 Pac. 706;

Thomas v. Lamb, 50 Cal. App. 483; 195 Pac. 441;

Sacramento Bank v. Murphy, 158 Cal. 390, 394; 115 Pac. 232;

Norton v. Norton, 50 Cal. App. 483; 195 Pac. 441.

III. The claim of F. R. Kenney and L. W. Wickes constitutes a lien upon the property described in said chattel mortgage and deed of trust, prior and paramount to the lien of the State of California upon said property

for penalties added to license taxes due on account of motor vehicle fuel sold and delivered by El Camino Oil Company, Ltd., from and including the first day of April, 1930, to and including the tenth day of June, 1930.

W. P. Fuller & Co. v. McClure, 48 Cal. App. 185, 191 Pac. 1027.

IV. The claim of F. R. Kenney and L. W. Wickes constitutes a lien upon the property described in said deed of trust and chattel mortgage prior and paramount to the lien of the State of California upon said property for license taxes due on account of motor vehicle fuel sold and delivered by El Camino Oil Company, Ltd., subsequent to the tenth day of June, 1930, together with penalties thereon for delinquencies.

California Motor Vehicle Fuel License Tax Act, Section 4 (Calif. Stats. 1923, p. 572, as amended by Calif. Stats. 1925, p. 659);

California Political Code (1897), Sections 3716 and 3788;

California Code of Civil Procedure, Sections 681 and 685;

Blood v. Light, 38 Cal. 649; 99 Am. Dec. 441;

Lean v. Givens, 146 Cal. 739; 81 Pac. 128;

San Francisco Breweries v. Schurtz, 104 Cal. 420; 38 Pac. 92;

Martin v. Heldebrand, 190 Cal. 369; 212 Pac. 618;

King v. Gotz, 70 Cal. 236; 11 Pac. 656;

Heath v. Wilson, 139 Cal. 362; 73 Pac. 182;

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Weber v. McCleverty, 149 Cal. 316; 86 Pac. 706;

Sacramento Bank v. Murphy, 158 Cal. 390; 115 Pac. 232;

Faias v. Superior Court, 133 Cal. App. 525; 24 Pac. (2d) 567;

Palace Hotel Co. v. Crist, 6 Cal. App. (2d) 690; 45 Pac. (2d) 415;

St. Clair v. Jones, 58 Ind. App. 280; 108 N. E. 256;

Central Trust Co. of New York v. Third Ave. R. R. Co. (C. C. A. 2d), 186 Fed. 291;

Guinn v. McReynolds, 177 Cal. 230; 170 Pac. 421;

California Loan and Trust Co. v. Weiss, 118 Cal. 489; 50 Pac. 697;

Scottish American Mortgage Co. v. Minidoka County, 47 Idaho 33; 272 Pac. 498;

Carstens & Earles v. City of Seattle, 84 Wash. 88; 146 Pac. 381;

Miller v. Anderson, 1 S. D. 539; 47 N. W. 957;

Pauley v. State of California (C. C. A. 9th), 75 Fed. (2d) 120;

Smith v. Skow, 97 Iowa 640; 66 N. W. 893;

Advance Thresher Co. v. Beck, 21 N. D. 55; 128 N. W. 315;

Cooley, The Law of Taxation, paragraph 1240.

ARGUMENT.

I.

The Claim of F. R. Kenney and L. W. Wickes Is Secured by a Chattel Mortgage Dated the Sixth Day of June, 1930, Executed by El Camino Oil Company, Ltd., Respondent Herein, and Recorded in the Office of the County Recorder of Los Angeles County the Tenth Day of June, 1930.

Point One of the appellant's opening brief, pages 15-41, is a contention that the chattel mortgage securing payment of the $10,000.00 note executed and delivered by respondent to appellees Kenney and Wickes has been released.

In outline form appellant's argument is:

Since:

I. $10,000 note and chattel mortgage were executed and delivered prior to the $80,000.00 note and trust deed; and

II. Both notes were executed and delivered to evidence an undetermined indebtedness; and

III. The indebtedness was determined thereafter to be $78,046.60;

Therefore:

I. Respondent was entitled to a "credit" of $11,953.40; and

II. The $10,000.00 note, being first in time was discharged; and

III. The chattel mortgage was released.

The fallacy in appellant's argument lies in the assumption that respondent was entitled to a "credit" of $11,953.40. To make this assumption appellant needed to assume an indebtedness of $90,000.00 to which this "credit" might be applied.

The indebtedness was determined to be $78,046.60 and no more. Respondent still owes that principal amount and at no time was it entitled to a credit of any kind.

The only effect of respondent's executing two notes was to give Kenney and Wickes two causes of action against respondent with the added condition that judgment could be limited to $78,046.60. Kenney and Wickes, except for the present receivership matter, could file action on both notes or either note and respondent would have no defense until the indebtedness of $78,046.60, with interest, was discharged.

If appellant's theory were correct, and assuming that instead of taking two notes Kenney and Wickes had taken one note for $90,000.00 secured by the same property actually covered by both the chattel mortgages and the deed of trust, then, according to appellant, the respondent would be entitled to a "credit" of $11,953.40 and *the discharge of the security lien in a proportionate amount*. This is an untenable view since the lien remains as security until the debt is fully paid.

Both the chattel mortgage and the deed of trust create liens to secure payment of the indebtedness of respondent and are not discharged until payment in full is made.

The District Court committed no error in holding the $10,000.00 note and the chattel mortgage valid existing instruments constituting a lien to secure payment to Kenney and Wickes of the $78,046.60 debt.

II.

The Deed of Trust Executed June 7, 1930, by El Camino Oil Company, Created and Constitutes a Valid and Existing Lien, as Against the State of California, Upon the Property Described in Said Deed of Trust as Parcel II.

Appellant's argument (B. Point Two, pp. 18-25, Appellant's Opening Brief) briefly summarized is that the conveyance of a leasehold interest to a trustee to secure payment of a note is in legal effect a chattel mortgage and the failure to comply with section 2957, Civil Code of California, requiring an affidavit of good faith to be endorsed on a chattel mortgage by the parties thereto, makes the same void as to a subsequent encumbrance of the property in good faith.

The flaws in appellant's argument lie in its assumptions first, that a leasehold is personal property, and second, that a conveyance in trust to secure payment of an obligation is a chattel mortgage.

The short and complete answer to this argument of appellant is found in the definitions of property and of mortgages in the Civil Code of California.

Section 657, Civil Code of California, provides:

> "Property is either: 1. Real or immovable; or, 2. Personal or movable."

The Legislature in adopting this definition expressed the intent that in so far as the State of California is concerned real and immovable property are one and the same thing and that the terms "real" and "immovable" are interchangeable at will.

That a leasehold, *i. e.,* a term for years, is a chattel real and immovable (and therefore real property by definition in California), is well settled.

Insurance Co. v. Haven, 95 U. S. 251;

Hawkins v. Trust Co., 79 Fed. 50.

Appellees Kenney and Wickes admit that the California courts have in several instances dealt with leasehold estates as though the same were personal property, which at common law they were. These appellees feel however that the expressed intent of the Legislature is clear, unambiguous, and should rule.

Section 2924 of the Civil Code of California provides in part:

> "Every transfer of an interest in property, *other than in trust,* made only as a security for the performance of another act, is to be deemed a mortgage, except when in the case of personal property it is accompanied by actual change of possession, in which case it is to be deemed a pledge * * *." (Italics appellees'.)

The above language is now and has been for at least twenty years past a part of said section though the section as a whole has been amended several times.

By this express exclusion of transfers in trust from the definition of mortgages it follows that a conveyance in trust is not a mortgage, and that the rules applicable to the valid execution of mortgages, chattel or otherwise, have no application to deeds of trust. Therefore the fact

that the deed of trust executed and delivered to appellees Kenney and Wickes to secure payment of respondent's $80,000.00 note did not contain the affidavit of good faith required in valid chattel mortgages does not invalidate said deed of trust with respect to Parcel II therein described. [Tr. p. 29.]

The California courts recognize the legal distinction between deeds of trust and mortgages, and hold that even though the practical effect of a deed of trust is similar to that of a mortgage containing a power of sale, nevertheless a deed of trust is not a mortgage and it is legally impossible to hold that the trustee has a lien on the property conveyed in trust or to hold that the property is subject to a lien.

Weber v. McCleverty, 149 Cal. 316; 86 Pac. 706;

Sacramento Bank v. Murphy, 158 Cal. 390, 394; 115 Pac. 232.

Trusts in personalty are valid in California.

Thomas v. Lamb, 11 Cal. App. 717; 106 Pac. 254;

Norton v. Norton, 50 Cal. App. 483; 195 Pac. 441;

Civil Code of California, Section 2220.

The District Court committed no error in ruling that the deed of trust executed by respondent to secure its note for $80,000.00 was and is a valid instrument which created with respect to parcels both I and II upon recordation a lien valid as against the State of California.

III.

The Claim of F. R. Kenney and L. W. Wickes Constitutes a Lien Upon the Property Described in Said Chattel Mortgage and Deed of Trust, Prior and Paramount to the Lien of the State of California Upon Said Property for Penalties Added to License Taxes Due on Account of Motor Vehicle Fuel Sold and Delivered by El Camino Oil Co., Ltd., From and Including the First Day of April, 1930, to and Including the Tenth Day of June, 1930.

Appellant's argument in brief is that the lien of a penalty for failure to pay taxes become a lien as of the date at which the taxes became a lien and not at the date upon which the penalty for non-payment accrued.

Three periods to be considered in this portion of the argument are:

1. April 1 to June 10, 1930, the period during which taxes accrued and became a lien upon the property of respondent.
2. June 10, 1930, the date upon which the chattel mortgage and deed of trust, executed by respondent to secure to Kenney and Wickes payment of the notes for $10,000.00 and $80,000.00, were recorded.
3. August 15, 1930, the date upon which a ten per cent (10%) penalty was added to the taxes for non-payment thereof by respondent.

Appellant contends that since the penalty, when and if it arises, becomes part of the tax, it necessarily follows that the lien for the penalty must date back to the time of the accrual of the tax. This statement is not well taken in law or logic. It is not logical for the reason that

there are open alternatives and the arbitrary choice of the alternative favorable to the appellant is wish-thinking, not reason. It is just as logical, and more natural, to maintain that the lien for the penalty attaches at the time the penalty comes into existence, as to maintain the lien dates back.

Appellees Kenney and Wickes have found no authority directly on the point but respectfully call the court's attention to the rules governing mortgages securing future advances which offer a fair and proper analogy.

The rule, of course, is that the future advances, when made, have priority over liens arising between the time of making the mortgage and the time of making the advance, *if said advance was obligatory upon the mortgagee by the terms of the mortgage.* The intervening lien has priority over the lien for the future advance when the advance is voluntary and cannot be forced even though it may have been contemplated by the terms of the mortgage.

W. P. Fuller & Co. v. McClure, 48 Cal. App. 185; 191 Pac. 1027.

In the present instance when the tax accrued there was no obligation to pay a penalty and also the same situation existed when the chattel mortgage and trust deed were recorded. If there had been a foreclosure by Kenney and Wickes after the recording of the chattel mortgage and trust deed and before accrual of the penalty the State of California most certainly could not look to Kenney and Wickes for payment of the penalty and yet that is in effect the result of the present contention of appellant.

It appears that logically, by analogy and on the ground of just and equitable determination of priorities, that the lien for the penalty should be held to have attached on August 15, 1930, and not at any time prior thereto.

The ruling of the District Court so holding is well reasoned and proper.

IV.

The Claim of F. R. Kenney and L. W. Wickes Constitutes a Lien Upon the Property Described in Said Deed of Trust and Chattel Mortgage Prior and Paramount to the Lien of the State of California Upon Said Property for License Taxes Due on Account of Motor Vehicle Fuel Sold and Delivered by Said El Camino Oil Company, Ltd., Subsequent to the Tenth Day of June, 1930, Together With Penalties Thereon for Delinquencies.

The problem placed before the court by Point Four of appellant's argument, pages 31-37 of appellant's opening brief, is one of interpretation of the California Motor Vehicle Fuel License Tax Act, section 4, as it existed in 1930.

Said statute then provided in section 4, in part, that said tax—

> "shall have the effect of an execution duly levied against all the property of the distributor, and shall remain until the tax is paid or the property sold for the payment thereof * * *."

It is proper to ask, first, what is the effect of an execution duly levied against all the property of the distributor. *Blood v. Light,* 38 Cal. 649; 99 Am. Dec. 441, holds that the only effect of a levy of execution is to fix the date of the sheriff's title as against persons not parties to the writ.

Lean v. Givens, 146 Cal. 739; 81 Pac. 128, holds that an execution when levied makes a lien or charge against the property levied on.

The following cases hold that the levy of an execution subjects the property of the debtor to sale to satisfy the judgment against the debtor but that the execution sale does not affect prior liens and that the purchaser of an execution sale takes subject to prior liens.

San Francisco Breweries v. Schurtz, 104 Cal. 420; 38 Pac. 92;

Martin v. Heldebrand, 190 Cal. 369; 212 Pac. 618.

Particularly applicable to the present question are the following cases which hold that the only property a debtor has as trustor under a deed of trust is an equitable right to a reconveyance upon payment of his indebtedness and the right to receive any surplus upon a sale by the trustee and that *only such equitable rights are reached by an execution.*

King v. Gotz, 70 Cal. 236; 11 Pac. 656;

Heath v. Wilson, 139 Cal. 362; 73 Pac. 182;

Brown v. Campbell, 100 Cal. 635; 35 Pac. 433.

This reasoning by the California courts is consistent with the theory mentioned in Point II of argument above to the effect that a trust deed conveys legal title and does not create an encumbrance or lien.

Weber v. McCleverty, supra;

Sacramento Bank v. Murphy, supra.

There is no doubt but that the Legislature in adopting the language it did in said section 4 of the Motor Vehicle Fuel License Tax Act did so knowing that an execution lien does not affect liens prior in time to the levy. In expressly adopting such language it seems clear that it

expressly intended the tax lien should not take priority over valid liens prior in time.

Next it is proper to ask why the Legislature added the words—"and shall remain until the tax is paid or the property sold for the payment thereof * * *."

Appellees Kenney and Wickes feel that it is clear such language was added in order to remove a possible bar to enforcement of the tax lien after a period of five years. Since the Legislature saw fit to make the tax lien equivalent to the lien of an execution it also saw fit to keep that equality until the tax was paid or the property sold by expressly removing any thought that the tax lien might become outlawed.

The possible limitation arises from the provisions of sections 681 and 685 of the Code of Civil Procedure of the State of California. Said sections make it necessary to apply for a writ of execution within five years after entry of judgment and any application made thereafter is not granted as a matter of right but only in the sound discretion of the court. See the following cases:

Faias v. Superior Court, 133 Cal. App. 525; 24 Pac. (2d) 567;

Palace Hotel Co. v. Crist, 6 Cal. App. (2d) 690; 45 Pac. (2d) 415.

The contention of these appellees that the act in question merely provides for a lien not subjected to a limitation in time and does not attempt to give that lien priority over existing encumbrances is borne out by the following authorities as well as by the reasonable interpretation of the exact language used in the act.

St. Clair v. Jones, 58 Ind. App. 280; 108 N. E. 256, holds that a statute which provided that the lien of the state for all taxes should attach on all real estate and should be perpetual for all taxes due from the owner thereof until paid gave no priority to the tax lien.

Central Trust Co. of New York v. Third Ave. R. R. Co. (C. C. A. 2d), 186 Fed. 291, holds that the language of a statute making a franchise tax a lien upon a corporation's real and personal property "from the time when it is payable until the same is paid in full," did not make the tax lien prior to an existing mortgage.

Guinn v. McReynolds, 177 Cal. 230; 170 Pac. 421, holds that a lien created to secure repayment of money expended by the county horticultural commissioner in eradication of insects was not prior to an antecedent mortgage. The court said:

> "But the authorities declare, virtually without dissent, that even a tax lien is not entitled to rank ahead of a pre-existing mortgage, or other contract lien, unless the legislative enactment creating the tax has given it priority."

Appellant contends that *California Loan and Trust Co. v. Weiss,* 118 Cal. 489, 50 Pac. 697, is ample authority for holding that the Motor Vehicle Fuel License Tax Act, as it provided in 1930, gives the state a lien for unpaid taxes prior to pre-existing contract liens.

That case involved the question of priority between the title acquired by a purchaser at a tax sale and the lien of a mortgage which attached to the land prior in time to the lien of the taxes, which said taxes, under section 3716 of the Political Code (1897), were made a lien upon real

property and were not removed "until the taxes were paid or the property sold for the payment thereof." The court discussed the effect of this language and made certain comments with respect thereto, but did not make the construction of that section the basis for its decision, and held that the need of construction was removed by reason of the provisions of section 3788 of the Political Code, saying at page 495:

> "* * * but that language is aided so as to remove the need of interpretation by section 3788, which provides that the deed conveys the absolute title free from all encumbrances."

The court then went on, basing its decision upon the provisions of section 3788, which provides that a deed to a grantee conveys absolute title, free and clear of all encumbrances. The language of the decision, therefore, with respect to the provisions of section 3716, providing that a tax shall remain a lien until paid, is mere dicta, and it is submitted that, in the light of the great weight of authority to the contrary, further weight should not be given to this unguarded dicta.

No provision existed in 1930 in the law of California which could enlarge the language of the Motor Vehicle Fuel License Tax Act as section 3788, Political Code of California (1897), enlarged the language of section 3716, Political Code of California (1897).

At the very least there is uncertainty and ambiguity with respect to the legislative intent as expressed in section 4 of the Motor Vehicle Fuel License Tax Act as it read

in 1930. It is a settled rule of law that tax statutes should be strictly construed against the state.

Guinn v. McReynolds, supra;
Cooley, The Law of Taxation, paragraph 1240.

The appellant state by its contention would have the court impose the burden of a mere license tax upon not only the property of the obligor El Camino Oil Company, Ltd., respondent herein, but upon the appellees Kenney and Wickes who acquired the legal title to the property prior to the accrual of taxes after June 10, 1930. In effect the action of the appellant state is an attempt to change the obligor of the license or privilege tax from respondent herein to appellees Kenney and Wickes. The injustice of such a contention is so clear that courts in similar situations have repeatedly refused to extend the lien for taxes imposed upon one property to priority over pre-existing liens upon other property.

Scottish American Mortgage Co. v. Minidoka County, 47 Idaho 33; 272 Pac. 498;
Carstens & Earles v. City of Seattle, 84 Wash. 88; 146 Pac. 381;
Miller v. Anderson, 1 S. D. 539; 47 N. W. 957.

The tax imposed by the Motor Vehicle Fuel Tax Act is a license, excise, privilege or occupation tax upon the business of selling motor vehicle fuel.

Panley v. State of California (C. C. A. 9th), 75 Fed. (2d) 120.

The doctrine that taxes are superior to pre-existing contract liens should be limited to general taxes and not extended to liens for license and excise taxes.

Smith v. Skow, 97 Iowa 640; 66 N. W. 893.

The constitutional power of the state to grant priority over antecedent liens of a tax imposed upon property other than that upon which the tax is levied is so doubtful that a construction granting such priority should be avoided.

Scottish American Mortgage Co. v. Minidoka County, supra;

Advance Thresher Co. v. Beck, 21 N. D. 55; 128 N. W. 315.

The District Court very properly ruled that the claim of appellees Kenney and Wickes based upon said chattel mortgage and deed of trust is prior and paramount to the claim of the State of California based upon its lien for taxes accruing subsequent to June 10, 1930.

Conclusion.

Appellees Kenney and Wickes respectfully submit that the authorities cited in this brief as well as general principles of law and equity indicate that the court below properly made its order sustaining the validity of the chattel mortgage and deed of trust securing the claim of Kenney and Wickes against respondent and that their claim is prior and paramount to the claim and lien of the State of California for all taxes and penalties accruing after June 10, 1930, because of motor vehicle fuel sold by respondent El Camino Oil Company, Ltd., and that these authorities and principles should induce this Honorable Court to affirm the order of the court below and deny the appeal herein.

Respectfully submitted,

A. Maxson Smith,

Attorney for Appellees F. R. Kenney and L. W. Wickes.